

7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

RIN 3133-AD71

Short-Term, Small Amount Loans

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is amending its general lending rule to enable federal credit unions (FCUs) to offer short-term, small amount loans (STS loans) as a viable alternative to predatory payday loans. The amendment permits FCUs to charge a higher interest rate for an STS loan than is permitted under the general lending rule, but imposes limitations on the permissible term, amount, and fees associated with an STS loan. This final rule also requires an FCU to set a cap on the total dollar amount of STS loans it will make and to set a length of membership requirement of at least one month. Also, any loan under this rule must be fully amortized. The STS loan alternative will assist FCUs in meeting

their mission to promote thrift and meet their members' credit needs, particularly the provident needs of members of modest means. Permitting a higher interest rate for STS loans will allow FCUs to make loans cost effective while the limitations will appropriately constrain the product to meeting its purpose as an alternative to predatory credit products. This final rule also includes guidance in the form of "best practices" FCUs should consider incorporating into their individual STS programs.

DATES: This rule will become effective on [INSERT DATE THAT IS THIRTY DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT: Justin M. Anderson, Staff Attorney, Office of General Counsel, at the above address or telephone (703) 518-6540.

SUPPLEMENTARY INFORMATION:

A. Background

The Federal Credit Union Act (the Act) permits FCUs to make loans and extend lines of credit to members but prohibits FCUs from charging an annual percentage rate (APR), inclusive of all finance charges, above 15%. 12 U.S.C. 1757(5)(A)(vi). The Act, however, permits the NCUA Board (the Board), after considering certain statutory criteria, to establish a higher interest rate ceiling in 18-month cycles. *Id.* At its July 2009 meeting, the Board reapproved an APR

ceiling of 18%, effective until March 10, 2011. NCUA Letter to Federal Credit Unions 09-FCU-06 (July 2009).

The Board reviewed NCUA's regulatory structure and recognized that under this current structure many FCUs could not provide their members with a reasonable alternative to traditional payday loans. The Board, therefore, considered amending its regulations to provide FCUs with a regulatory structure under which they could offer a responsible payday loan alternative to members in a safe and sound manner.

B. Proposed Rule

On April 29, 2010, the Board issued a proposed rule amending §701.21 to increase the interest rate ceiling for STS loans, provided FCUs made the loans within the requirements of the rule. 75 FR 2447 (May 5, 2010). The Board also specifically asked for comments on the issues of amortization, utilizing a 36% APR inclusive of all fees, and requiring members to participate in direct deposit or payroll deduct. The comment period closed on July 6, 2010. The Board received 31 comments from: two credit union trade associations; one bank trade association; two private citizens; fifteen credit unions; seven state credit union leagues; three consumer advocacy groups; and one philanthropic foundation. Commenters addressed a wide range of issues including the different requirements of the rule, those areas where the Board specifically requested comment, and other aspects of payday lending that were not related to this rule.

C. Summary of Comments

1. General

While most commenters supported the idea and framework of the rule, many commenters offered a suggestion on one or more aspects of the proposal. There were, however, three commenters that supported the proposed rule as drafted, four that did not support the rule, and one that only provided details about its payday alternative program. The commenters that supported the rule as written believe the rule would be a valuable tool FCUs could use to assist their members, is in-line with the mission and purpose of the FCU charter, and would provide members with a way to safely break the payday loan cycle.

Of the commenters that did not support the rule, one commenter generally opposed the idea of payday lending and believed NCUA should monitor and regulate existing programs, rather than help foster an alternative. Two other commenters did not believe the terms of the rule would be attractive to FCUs or borrowers. Finally, one commenter believed credit unions should be permitted to develop their own programs instead of NCUA creating one. With respect to the last comment, the Board notes this final rule does not prohibit an FCU from continuing or participating in a closed or open-end payday loan program that operates successfully and legally under NCUA's Regulations and the Federal Reserve Board's Regulation Z (Reg Z). 12 CFR Part 226.

2. Specific Comments and NCUA's Response.

The remaining 23 commenters generally supported the rule, but offered suggestions on specific aspects of the rule or provided comments on the sections where the Board specifically requested comments. The Board considered all of the comments and modified the final rule where appropriate. The specific comments and NCUA's responses are discussed in the following section-by-section analysis.

a. Permissible interest rate.

A majority of the commenters believed an interest rate ceiling of 1000 basis points above the established general interest rate ceiling, as set by the Board, was sufficient for FCUs offering an STS product. As noted above, the Board set interest rate ceiling is currently at 18%. A few other commenters, however, provided alternative suggestions for the Board's consideration. Two commenters believed the interest rate ceiling for STS loans should be higher to account for the higher degree of risk associated with this type of lending, but did not provide a specific interest rate they favored. Two other commenters believed a 36% all inclusive APR was appropriate, citing a relation to the Department of Defense (DOD) regulations and the need to keep costs as low as possible for borrowers. Two commenters advocated maximum flexibility and believed FCUs should be permitted to choose between a 36% all inclusive APR and the proposed rate and fee structure. One commenter believed the APR for STS loans should be 36% plus a \$20 application fee. Other individual commenters suggested approaches,

such as an 18% APR with a broader definition of finance charges, allowing a 28% APR for all legally permissible payday programs, and not increasing the APR at all.

The Board has considered these comments and, based on the reasons set forth in the preamble to the proposed rule, has decided to proceed with the proposed structure of an APR 1000 basis points above the Board approved interest rate ceiling, which currently would be 28%, and a \$20 application fee.

With respect to the comments on FCUs being able to offer this product to members of the military, the Board notes that the definition of a payday loan in the DOD regulations would not include most loans made under this final rule.

The DOD regulations provide the following definition of a payday loan:

(i) Payday loans. Closed-end credit with a term of 91 days or fewer in which the amount financed does not exceed \$2,000 and the covered borrower:

(A) Receives funds from and incurs interest and/or is charged a fee by a creditor, and contemporaneously with the receipt of funds, provides a check or other payment instrument to the creditor who agrees with the covered borrower not to deposit or present the check or payment instrument for more than one day, or;

(B) Receives funds from and incurs interest and/or is charged a fee by a creditor, and contemporaneously with the receipt of funds, authorizes the creditor to initiate a debit or debits to the covered borrower's deposit account (by electronic fund transfer or remotely created check) after one or more days. This provision does not apply to any right of a depository institution under statute or common law to offset indebtedness against funds on deposit in the event of the covered borrower's delinquency or default.

32 CFR §232.2. Under the terms of this final rule, all STS loans will be for less than \$2,000 and many will have maturities less than 91 days. The terms of this final rule, however, do not require an FCU to obtain a check or payment instrument or authorization to debit a member's account contemporaneously with an extension of credit. Further, NCUA does not generally expect FCUs to need to require a check or payment instrument and, as discussed below, FCUs are prohibited from conditioning the extension of credit on a member's consent for electronic debit. An FCU, therefore, will typically be able to offer loans under the terms of this rule to members of the military without violating the DOD regulations.

b. Loan Term

Approximately one-third of the commenters submitted comments on the proposed permissible loan term. Of those commenters, most believed the minimum loan term should be greater than 30 days, with commenters citing a range between 90-120 days as an acceptable minimum term. Some commenters also believed the maximum loan terms should also be longer, citing 12 to 18 months as an acceptable range for the maximum loan term. The commenters who advocated for a longer term believed that a longer term was necessary to enable borrowers to pay back a loan in small, more manageable payments.

After considering the comments and for the reasons articulated in the preamble to the proposed rule, the Board has decided to keep the proposed terms of a minimum maturity of one month and a maximum maturity of six months. The Board believes this final rule should provide a high level of protection for borrowers, and is concerned that longer term loans may actually have unintended negative consequences. The Board is specifically concerned that borrowers with longer term STS loans may continue to use payday lenders to cover expenses that arise during repayment. While it is possible that this scenario may also occur under the maturity structure in this rule, the Board believes loans with maturities between one and six months will provide borrowers with frequent enough access to credit to minimize the need for additional loans from payday lenders. To effectuate the beneficial nature of a one to six month

maturity and ensure maximum borrower protection, the Board is reaffirming its statement in the preamble to the proposed rule that FCUs should structure the terms of an STS loan in a way that allows a borrower to repay the loan in the given term. NCUA will scrutinize an FCU's program to ensure loans are being made in a way that provides a member with the best chance to successfully repay a loan made under this rule.

c. Number of loans and roll-overs

Approximately one-third of the commenters addressed the issues of roll-overs and the permissible number of loans. While most commenters agreed the final rule should prohibit roll-overs, there were three commenters that believed roll-overs could be appropriate in limited circumstances. The commenters cited that without roll-overs a borrower who cannot pay off the loan within the loan term will incur late fees and, possibly, a negative entry on his or her credit report. Also, one commenter asked for further clarification of the term "roll-over" in the final rule.

After considering these comments, the Board has determined to keep the prohibition against roll-overs, but will provide some flexibility in the final rule so borrowers can meet their payment obligations without incurring additional fees. While the Board continues to disagree that roll-overs are ever appropriate, it believes permitting FCUs to extend the term of a loan, without any additional

fees, may be beneficial to both FCUs and borrowers. The prohibition against roll-overs in this rule applies to situations in which a borrower is charged additional fees for extending or “re-borrowing” funds to avoid delinquency. Under this rule, an FCU may, however, extend the term of the loan, within the maximum loan term set by this rule, provided the FCU does not charge any additional fees, except interest, or extend any additional funds. For example, if a borrower takes out a \$300 loan for three months and, at some point within those three months, is unable to continue making payments, the FCU can extend the loan term for another one to three months, but cannot extend any new credit or charge additional fees in connection with this extension. The Board believes allowing for an extension without any additional fees will provide borrowers with the best opportunity to repay the loan and avoid delinquencies. NCUA generally expects FCUs, however, to set the term and amount of the loan in a way that allows borrowers to repay it within the term and avoid the need to extend a loan.

With respect to the number of loans, most commenters believed there should be a higher limit on the number of loans a borrower may have in a 12-month period or no cap at all. Commenters believed that the number imposed in the proposed rule was too limiting and could drive borrowers back to payday lenders.

After considering these comments the Board has determined to proceed with the terms in the proposed rule, which limit FCUs to making only one loan at a time to a member and no more than three in any rolling six-month period.

In response to the commenters advocating for a higher number of loans, the Board disagrees that a limited number of loans will push borrowers back to payday lenders. As noted above, the Board intends this rule to provide borrowers with enough access to credit to preclude the need for a borrower to also borrow from a payday lender. The Board also intends this rule to help borrowers curtail the repetitive use of payday loans and transition them to more mainstream financial products and more responsible borrowing. A cap of three loans in any rolling six-month period coupled with the minimum and maximum maturities, set out above, achieves this balance of providing borrowers with sufficient access to credit while helping borrowers transition from a reliance on repetitive borrowings.

d. Application fee and amount of the loan

Approximately one-half of the commenters addressed the appropriate amount of an application fee. Two commenters believed \$20 was an appropriate amount but two other commenters felt an application fee should be capped at \$25. Of the remaining commenters, four believed the application fee should be higher, but did not provide a specific amount and several commenters believed FCUs should be permitted to set their own application fees in accordance with Regulation Z or the application fee should be tied to the amount of the loan. All commenters who sought a higher application fee cited an increased risk in this type of lending. Two commenters believed FCUs should charge a borrower only one \$20 application fee every six months and two commenters believed the

Board should not permit FCUs to charge any fees for these loans, including application and late fees. All commenters who favored a lower fee or no fee cited a minimal underwriting process that does not justify a fee.

After considering the comments, the Board has decided to keep the proposed maximum application fee of \$20. While the Board agrees that this type of lending is inherently riskier than many other types of lending, it is interest income and not the application fee that allows FCUs to offset the higher degree of risk. The Board notes, Reg Z limits application fees to the recovery of costs associated with processing applications for credit that are charged to all consumers who apply, regardless if credit is actually extended. 12 CFR §226.4(c)(1). For the reasons articulated in the preamble to the proposed rule, the Board believes a maximum application fee of \$20 is sufficient to allow FCUs to recoup the costs associated with processing an application for an STS loan. With regard to those commenters who argued for a lower application fee or a restriction that application fees be charged only once in a six-month period, the Board points out that \$20 under this rule is the maximum amount FCUs can charge for an application fee and that FCUs are still bound by the definition of application fee in Reg Z. As such, an FCU's application fee can only be the amount needed to recoup the actual costs associated with processing an application. If an FCU undertakes a more limited application process with repeat borrowers, there would be no justification for charging the same application fee each time the borrower applied. NCUA will scrutinize application fees to ensure FCUs are using the fee

to recoup costs associated with processing an application and not to account for the riskier nature of this type of lending.

On the issue of the permissible amount of a loan, slightly less than one-half of the commenters provided suggestions. A majority of the commenters believed the minimum loan amount should be less than \$200, citing a high demand for loans between \$50 and \$100. One commenter believed the minimum loan amount was acceptable, but the maximum loan amount should be \$2,500. Finally, one commenter believed that the maximum amount should be lowered because most payday borrowers cannot pay back \$1,000, even over a six-month period.

The Board believes the proposed minimum loan amount of \$200 and the proposed maximum amount of \$1000 are appropriate and has included these amounts in the final rule. With respect to those commenters who advocated for a lower minimum amount, the Board notes, as discussed above, that this rule does not prohibit FCUs from making smaller loans that are legal under NCUA's regulations and Reg Z. Also, as noted in the preamble to the proposed rule, a minimum loan amount of \$200 is in-line with the typical loan extended to payday loan borrowers.

In response to the commenter who argued that the maximum loan amount should be \$2,500, the Board does not believe it would be prudent to allow FCUs

to lend amounts over \$1,000 to borrowers at terms of six-months or less. As noted in the preamble to the proposed rule, the Board chose a maximum loan amount of \$1,000 because it may allow borrowers to repay loans from payday lenders and transition to more traditional FCU products while still being a manageable short-term loan.

Finally, in response to the comment that most borrowers could not pay back \$1,000 in six-months and, therefore, the maximum amount should be lower, the Board notes the discussion above regarding the impetus for a maximum loan of \$1,000. In addition, as discussed earlier in this preamble, the Board expects FCUs to extend loans to borrowers in amounts and under terms in which the borrower can manage repayment of the loan, within the confines of this rule.

e. Amortization and length of membership requirements

In response to the Board's specific request for comment on the issue of amortization, approximately one-third of the commenters provided a response. The majority of those commenters believed that the final rule should require FCUs to fully amortize STS loans. There were two commenters, however, that believed FCUs should have the option to use balloon payments, citing that, in limited circumstances, balloon payments may actually benefit members.

The Board agrees with the majority of the commenters that FCUs should fully amortize loans made under this rule, and is including a specific requirement in

the final rule. The Board notes that balloon payments often create additional difficulty for borrowers trying to repay their loans, and requiring FCUs to fully amortize the loans will allow borrowers to make manageable payments over the term of the loan, rather than trying to make one large payment. Under the requirement to amortize a loan, FCUs must structure the payments so that the borrower is paying a portion of the principal and interest in equal or near-equal installments on a periodic basis over the course of the loan. While the Board is not prescribing specific payment schedules, i.e. monthly or bi-weekly, FCUs should offer payment schedules that allow borrowers to easily repay the loan within the given term.

Approximately one-quarter of the commenters addressed the issue of a length of membership requirement. Of those commenters, all but one believed FCUs should have the option to impose a length of membership requirement, but that it should not be a regulatory requirement. The Board disagrees that FCUs should have the option of setting a length of membership requirement and has included a requirement in the final rule that FCUs set a length of minimum membership requirement of at least one month. The Board wants to provide FCUs with as much flexibility as possible in developing an STS loan program, but it must consider the riskier nature of this type of loan and the safety and soundness of the FCUs offering them. The Board believes a minimum membership requirement of one month will build a meaningful relationship between the borrower and the FCU and help reduce the chance of a borrower defaulting on

an STS loan. While the final rule imposes a minimum requirement of one month, individual FCUs should evaluate their risk tolerance and set a membership requirement accordingly.

f. Lending cap and payroll deduct/direct deposit

Less than a quarter of the commenters addressed the issue of a lending cap. Of those commenters, there was an even split between the number of commenters that believed NCUA should impose a cap and those that believed the Board should permit FCUs to set their own cap. The Board received three suggestions on how to establish a cap: setting a cap at 20% of net worth; 5-10% of assets; and a cap only on the dollar amount of total loans made as a percentage of net worth.

After considering these comments, the Board has decided to require FCUs to set a cap in their written lending policies on the aggregate dollar amount of loans outstanding not to exceed 20% of total net worth. While the Board believes it is preferential to allow an FCU to evaluate its own risk tolerance and resources in setting a cap, the Board also wants to provide FCUs with a ceiling to ensure any cap set by an FCU is sufficient from a safety and soundness perspective. The Board believes a cap on the aggregate dollar amount with a ceiling of 20% net worth will be sufficient to ensure FCUs are not exposed to unnecessary risks and their resources are not stretched. Depending on the success of these programs, the Board can consider raising the cap ceiling at a later date.

Over half of the commenters addressed the issue of requiring credit unions to provide STS loans only to members that had direct deposit or authorized payroll deduction. Of those commenters, nearly three-quarters believed FCUs should have the option to require direct deposit or payroll deduct as part of their program, but it should not be a regulatory requirement. One commenter believed it should be a regulatory requirement and three believed the rule should specifically prohibit the practices. One of the commenters that believed the rule should prohibit the practices stated that requiring payroll deduct to obtain a loan was prohibited by the Federal Reserve Board's Regulation E.

The Board agrees with a majority of the commenters that direct deposit and payroll deduct for members should not be regulatory requirements. While the Board believes direct deposit is a useful tool for limiting risk, it recognizes that a regulatory requirement may restrict FCUs from offering STS loans to members who may not have access to direct deposit. Rather, the Board believes an FCU should be able to evaluate its risk tolerance and members' needs in determining whether or not to require members to participate in direct deposit in order to borrow an STS loan.

On the issue of payroll deduct, the Board notes that Regulation E prohibits financial institutions, including FCUs, from conditioning an extension of credit to a consumer on the consumer's repayment by preauthorized electronic fund

transfers. 12 CFR §205.10(e)(1). However, under Regulation E, FCUs can offer members a lower rate or other incentives if they participate in payroll deduct. 12 CFR Part 205, Supplement I, 205.10(e)(1). The Board believes that payroll deduction is an important tool for FCUs to utilize in lowering the risk associated with these loans. Based on these considerations, the Board will let individual FCUs decide if they wish to provide an incentive to or encourage members to utilize payroll deduct or other pre-authorized electronic fund transfers, but will not include any regulatory requirement. The Board is also modifying the best practices section in the final rule to reflect these legal considerations regarding payroll deduction.

g. Underwriting and Best Practices

In addition to comments on the specific requirements of the rule, the Board also received a few comments requesting that it not require specific underwriting criteria in the regulation and also not change the best practices section into regulatory requirements. With regard to underwriting, the Board will proceed with the approach in the proposed rule that an FCU is required to establish underwriting standards in its written lending policies, but the Board will not require specific standards. The Board believes an FCU is in the best position to evaluate the needs of its members and its risk tolerance and set appropriate underwriting standards. The Board will also keep the underwriting in the best practices section to provide FCUs with guidance on how to structure underwriting for STS loans. With respect to the best practice section, the Board will keep the

approach in the proposed rule and offer this section as guidance and not as a regulatory requirement. While the Board believes the suggestions in the best practices section may be beneficial to FCUs and members, the Board also believes an FCU should have flexibility to determine the features of its own program.

h. Other Comments

In addition to the comments addressed above, the Board received several comments that did not address specific features of the rule, but warrant a discussion in this preamble. Several commenters asked NCUA to collect data about STS loans under this rule and reevaluate the requirements in a year. The Board agrees with these commenters and will modify the 5300 call report by January 2011 to include new sections to evaluate loan programs under this rule. One year from the effective date of this final rule the Board will evaluate the data collected on the 5300 call report and reevaluate the requirements in the final rule.

There were also several commenters that urged NCUA to take enforcement actions against FCUs that are offering predatory payday lending products. The Board notes that NCUA staff will continue to investigate programs that may be predatory in nature and take action where appropriate.

D. Dodd-Frank Wall Street Reform and Consumer Protection Act (The Dodd-Frank Act)

The Dodd-Frank Act, signed into law by President Obama on July 21, 2010, includes, as Title XII, the Improving Access to Mainstream Financial Institutions Act of 2010 (Title XII). Title XII, includes, among other things, federal assistance to federally-insured financial institutions that are providing small-dollar value loans. Specifically, §1205 of Title XII authorizes the Secretary of the Treasury to establish multi-year demonstration programs by means of grants, cooperative agreements, financial agency agreements, and similar contracts or undertakings with eligible entities to provide low-cost, small loans to consumers that will provide alternatives to more costly small dollar loans. The Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, §1205 (2010). Institutions participating in programs under this section are required to promote and provide financial education and literacy to small-dollar loan borrowers.

In addition, §1206 amends the Community Development Banking and Financial Institutions Act of 1994 by requiring the Community Development Fund (the Fund) to make grants to community development financial institutions (CDFIs) and to any other federally insured depository institution with a primary mission to serve targeted investment areas to enable such institutions to establish a loan-loss reserve fund to defray the costs of a small dollar loan program established or maintained by such institution. *Id.* at §1206(a)(1). Institutions accepting grants under this section are required to provide non-federal matching funds in

an amount equal to 50% of the grant. This section also requires the Fund to make technical assistance grants to be used for technology, staff support, and other costs associated with establishing a small-dollar loan program. To receive a grant or technical assistance grant under this section, a financial institution must have or establish a program with loans under \$2500 that are paid in installments with no pre-payment penalties, and the institution must report payments of the loan to at least one consumer reporting agency and meet any other affordability requirements established by the Administrator of the Fund. *Id.* at §1206(b). Title XII also grants the Secretary of the Treasury the authority to issue regulations implementing and administering the grants and programs discussed in Title XII. *Id.* at §1209.

The Board would like to clarify that the requirements of this final rule will not prohibit an FCU, which is otherwise eligible, from receiving a grant or participating in a program under Title XII. The requirements and best practices guidance in the final rule are in line with the requirements imposed by Title XII on participating financial institutions. FCUs will be able to comply with the requirements of the final rule to take advantage of the higher interest rate and still be within the limitations of Title XII.

As discussed above, the Secretary of the Treasury has the authority to issue regulations implementing Title XII and the Administrator of the Fund can impose other affordability requirements for grants. The Board will review any regulations

or requirements related to the Title XII grants and programs and compare them to the requirements in the final rule to ensure FCUs with STS loan programs can continue to take advantage of the benefits included in Title XII.

REGULATORY PROCEDURES

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a proposed rule may have on a substantial number of small credit unions (those under \$10 million in assets). This final rule increases the interest rate ceiling for STS loans and sets out several STS loan program requirements an FCU must meet to take advantage of the higher interest rates. The final rule will not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

This rule adds a requirement that federal credit unions establish a cap on short-term, small-dollar loans in their general written lending policies, which federal credit unions are already required to maintain and is currently approved under the Paperwork Reduction Act control number 3133-0139. NCUA has determined that the requirements of this rule are additions to an FCU's customary business

records and do not increase the paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The final rule will not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999 - Assessment of Federal Regulations and Policies on Families

NCUA has determined that this final rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

List of Subjects

12 CFR part 701

Credit unions, Federal credit unions

By the National Credit Union Administration Board on September 16, 2010.

Mary Rupp

Secretary of the Board

For the reasons discussed above, the National Credit Union Administration is amending 12 CFR §701.21(c)(7) as set forth below:

PART 701 – ORGANIZATION AND OPERATIONS OF FEDERAL CREDIT UNIONS

1. The authority citation for part 701 continues to read as follows:

Authority: 12 U.S.C. 1752(5), 1755, 1756, 1757, 1759, 1761a, 1761b, 766, 1767, 1782, 1784, 1787, 1789. Section 701.6 is also authorized by 15 U.S.C. 3717. Section 701.31 is also authorized by 15 U.S.C. 1601 et seq.; 42 U.S.C.

1981 and 3601–3610. Section 701.35 is also authorized by 42 U.S.C. 4311–4312.

In section 701.21(c)(7), add paragraph (c)(7)(iii) to read as follows:

§701.21 Loans to members and lines of credit to members

* * * * *

(c) * * *

(7) * * *

(iii) Short-term, small amount Loans (STS loans). (A) Notwithstanding the provisions in §701.21(c)(7)(ii), a federal credit union may charge an interest rate of 1000 basis points above the maximum interest rate as established by the Board, provided the federal credit union is making a closed-end loan in accordance with the following conditions:

(1) The principal of the loan is not less than \$200 or more than \$1000;

(2) The loan has a minimum maturity term of one month and a maximum maturity term of six months;

(3) The federal credit union does not make more than three STS loans in any rolling six-month period to any one borrower and makes no more than one short-term, small amount loan at a time to a borrower;

(4) The federal credit union must not roll-over any STS loan;

(a) The prohibition against roll-overs does not apply to an extension of the loan term within the maximum loan terms in paragraph (3) provided the federal credit union does not charge any additional fees or extend any new credit.

(5) The federal credit union fully amortizes the loan;

(6) The federal credit union sets a minimum length of membership requirement of at least one month;

(7) The federal credit union charges an application fee to all members applying for a new loan that reflects the actual costs associated with processing the application, but in no case may the application fee exceed \$20; and

(8) The federal credit union includes, in its written lending policies, a limit on the aggregate dollar amount of loans made under this section of a maximum of 20% of net worth and implements appropriate underwriting guidelines to minimize risk; for example, requiring a borrower to verify employment by producing at least two recent pay stubs.

(B) STS Loan Program Guidance and Best Practices. In developing a successful STS loan program, a federal credit union should consider how the program will help benefit a member's financial well-being while considering the higher degree of risk associated with this type of lending. The guidance and best practices are intended to help federal credit unions minimize risk and develop a successful program, but are not an exhaustive checklist and do not guarantee a successful program with a low degree of risk.

(1) Program Features. Several features that may increase the success of an STS loan program and enhance member benefit include adding a savings component, financial education, reporting of members' payment of STS loans to credit bureaus, or electronic loan transactions as part of an STS program. In addition, although a federal credit union cannot require members to authorize a payroll deduction, a federal credit union should encourage or incentivize members to utilize payroll deduction.

(2) Underwriting. Federal credit unions need to develop minimum underwriting standards that account for a member's need for quickly available funds, while adhering to principles of responsible lending. Underwriting standards should address required documentation for proof of employment or income, including at least two recent paycheck stubs. FCUs should be able to use a borrower's proof of recurring income as the key criterion in developing standards for maturity lengths and loan amounts so a borrower can manage repayment of the loan. For members with established accounts, FCUs should only need to review a member's account records and proof of recurring income or employment.

(3) Risk Avoidance. Federal credit unions need to consider risk avoidance strategies, including: requiring members to participate in direct deposit and conducting a thorough evaluation of the federal credit union's resources and ability to engage in an STS loan program.

